SABAH DVPT. BANK BHD.

v.

DATUK HONG TECK GUAN & ORS.

HIGH COURT BORNEO
SYED AHMAD IDID JC
[CIVIL SUIT NO. K. 66 OF 1988]
11 NOVEMBER 1991

CONTRACT: *Guarantee - Security of principal debtor for 1st loan - Subsequent loan given without knowledge of guarantors - Whether disposal of security of loan be utilised to settle 2nd and 3rd loan liability of guarantors - Whether 'catch - all proviso clause' material to compute liability.*

The plaintiff granted a loan to one Seng Ho Pemeliharaan Sdn. Bhd. ("the company"). This was guaranteed by the defendants. As security the plaintiff also had a charge over a specified land. Thereafter two other loans were given by the plaintiff to the company these were not guaranteed by the defendants, neither did they have knowledge of these loans.

The company failed to pay the loans, the plaintiff sold the charged land and used the proceeds to pay the 2nd and 3rd loans, as a result of this there was no balance from the proceeds of sale to settle the 1st loan.

The plaintiffs now claim from the defendants payment for the 1st loan they guaranteed.

Counsel for the defendants argued, by s. 94 of the Contracts Act 1950, that the defendant were absolved from the guarantee on the grounds that by the further encumbering of the land the plaintiff had deprived the defendant of the benefit of the land and had impaired and reduced the security when they granted the 2nd and 3rd loan.

The counsel for the plaintiff claim however that by cls 8 and 16 of the guarantee document the bank, *inter alia*, had power to give up any securities without exonerating the guarantors. They argued the effect of cls 8 and 16 was to disentitle the defendant to any rights under s. 94 Contracts Act 1950.

Held:

[1] Clauses 8 and 16 of the guarantee cannot disentitle the rights under s. 94 of the Contract Act 1990 because going back to the basics of Contract Law, the consents *ad idem* at the time the plaintiffs and the five defendants undertook the burden knowing fully accepting that the security was furnished by the charge on the land at that point of time that each of the five defendants only undertook to be liable only on the contract under the "Loan Agreement of even date". It is also basic guarantee law that no guarantor is to be additionally burdened without his knowledge of the implications of the guarantee.

[2] The guarantors were entitled to the benefit of every security which the creditor had against the principal debtor at the time the contract of suretyship was entered into that was on 27 June 1980 and not a day later. Hence, the later loans extended without the five defendants knowledge, albeit to the same customer could not become their responsibility nor their burden.

[3] In these circumstances the proceed realised from the sale of the charged land must go towards settling the 1st loan, i.e. the loan which was under contest.

[Plaintiffs' application for summary judgment dismissed.]

Cases referred to:

Re-Sherry, London and County Banking Co. v. Terry [1884] 25 Ch D 692 ***(cit)***
Mutton v. Peat [1900] 2 Ch 79 ***(cit)***
Re William Hall (Contractors) Ltd. [1967] 1 WLR 948 ***(cit)***
Lord Cottenham 3 HLC 226 ***(cit)***
Blest v. Brown [1862] 4 De GF & J 367 9 ***(cit)***
Ooi Boon Leong & Ors. v. Citibank N.A. [1984] 1 MLJ 222 ***(cit)***
D & C Nomura Merchant Bankers Bhd. v. Gunung Kuari Sdn. Bhd. & 3 Ors. [1990] 1 CLJ (Rep) 752 ***(cit)***
State of Maharashtra v. Dr. M.N. Kaur [1967] ASC 1634 ***(cit)***
Devaynes v. Noble [1816] 1 MER 572 ***(cit)***
The Mecca [1897] AC 286 ***(cit)***

Legislation referred to:

Contracts Act 1950, ss. 60, 61, 62, 94
Rules of the High Court 1980, O. 3 r. 5, O. 6 r. 4, O. 12 r. 7, O. 13 r. 1, O. 14, O. 18 r. 4

Other sources referred to:

Halsbury's Laws of England, 4th Edn., Vol. 3(1) para. 197, p. 169; Vol. 9, paras. 505 - 507
Pollock and Mulla's Indian Contract and Specific Relief Act p. 491 by J.L. Kapur

For the plaintiffs - Alex Decena; M/s. Jayasuriya Kah & Co.
For the 1st & 5th defendants - Peter S.C. Soong; M/s. Lawrence Chai & Peter Soong
For the 2nd defendant - Roderic Fernandez; M/s. Shelley Yap Leong Tseu Chong Chia & Co.
For the 4th defendant - Kong Hong Ming; M/s. Szetu & Co.

JUDGMENT

Syed Ahmad Idid JC:

The plaintiffs claimed against each of the five defendants RM5,741,822.33 and costs, charges, expenses and interest pursuant to a guarantee which they signed on 27 Jun 1980. The outstanding principal or the loan which plaintiffs actually granted to Seng Ho Pemeliharaan Sdn. Bhd. on 27 June 1980 was RM3,200,000. This increased to RM5,741,822.33 as at 31 January 1986 and to RM7,317,991.58 as at 31 December 1987 with the addition of interest in arrears and interest on delayed payment and expenses said to have been incurred.

Seng Ho Pemeliharaan Sdn. Bhd. defaulted in their payment of the loan and plaintiffs then demanded payments from the 1st, 2nd 3rd, 4th and 5th defendants through letter dated 10 March 1986 and 14 January 1987. The five defendants have failed to settle.

The 2nd defendant additionally grounded his defence that the "purported signature on the guarantee was a forgery and not (my) his own." He counterclaimed for a declaration that he is not bound under the guarantee and for costs. The 1st and 5th defendants filed their defence on 13 April 1988. Judgment in default of appearance (O. 13 r. 1) was entered against the 4th defendant on 21 March 1988. She then filed a summons-in-chambers on 10 October 1989 applying for an order to set aside that judgment.

In the meantime, there had been other documentations including:

(i) plaintiffs reply and defence to 2nd defendant's counterclaim on 4 May 1988

(ii) plaintiffs' reply to 1st and 5th defendants defence on 6 May 1988

(iii) summons-in-chambers under O. 12 r. 7, O. 6 r. 4, or O. 3 r. 5 to set aside the writ, the affidavit of the 4th defendant; and

(iv) summons-in-chambers under O. 18 r. 4 by 1st and 5th defendants that they be at liberty

to serve a rejoinder to plaintiffs' reply.

The 3rd defendant is not featured in these correspondence and the filing of documents. After the hearing on 2 October 1991, the firm of M/s. Jayasuriya Kah & Co., solicitors for the plaintiffs, submitted a photocopy of a letter from the Singapore Medical Centre certifying that the 3rd defendant suffered a severe brain haemorrhage and is now totally bed-ridden and under 24-hour nursing care. The 3rd defendant was adjudged a bankrupt by the High Court of Singapore on 22 August 1986.

Mr. Alex Decena, Counsel for the plaintiffs, said that fifteen issues had been raised between the 1st, 2nd and 5th defendants. The hearing on 2 October 1991 was on the summons-in-chambers application by plaintiffs dated 22 April 1988 against only the 1st, 2nd and 5th defendants. Basically, the two main heads of defence were firstly the alleged forgery of 2nd defendant's signature (which only 2nd defendant raised) and secondly in respect of the collateral security, that is whether the defendants had been discharged from their guarantee upon the plaintiffs' disposal of the borrower's land under Tawau CL No: 105371506.

Forgery - Allegation

As for the allegation that 2nd defendant's signature on the guarantee was forged, I am unable to accept such a contention. Given that he was away from the state on the day the documents were signed but as Mr. Decena rightly pointed out, the day/time was not crucial. So long as he signed it, albeit before or after the signing ceremony, his signature was valid. He did not make a police report and he did not really reject his signature as forgery. A bare denial was not sufficient.

Loans

Three loans were given to the same customer Seng Ho Pemeliharaan Udang Sdn. Bhd. (the borrower company or the principal under the guarantee). The first loan was for RM3,200,000 and is the subject matter of this action. The charged land was sold for RM12.2 million and sale was completed on 31 December 1987. The other two loans were of RM6.6 million on 24 October 1983 (called 2nd Loan) and RM1,647,615.95 given to the receiver after default of the 1st and 2nd loans and this sum was outstanding as at 26 January 1988 (called 3rd Loan) The plaintiffs claimed to have utilized the proceeds of sale (and the interest thereon) as follows:

(i)	RM 1,647,615.93	to settle the 3rd loan
(ii)	RM 9,500,000.00	to settle the 2nd loan (or at least a big part thereof)
(iii)	RM 1,172,620.36 RM12,320,236.29	placed on call

As a result there was no balance from the proceeds of sale to settle the 1st loan. As an initial observation, I would say that "it would be contrary to ordinary business and good faith to open a new account during the currency of the guaranteed one and carry all payments into the new account. *Re - Sherry London & Country Banking Co. v. Terry* [1884] 25 Ch D 692.

At this stage, it is pertinent to note:

(i) The proceeds of sale was paid to the plaintiffs on 26 January 1988. The question raised was "to which account did the plaintiffs appropriate the money? The method of book-keeping is not to prejudice the real rights of the surety. See *Mutton v. Peat* [1900] 2 Ch

79.

(ii) Did the plaintiffs maintain three separate accounts for the three loans? It would appear not. See plaintiffs' Exhs. FLCF2, FLCF-3 and FLCF4. The notice of demand dated 10 March 1986 stated that as at 23 January 1986 the sum of RM13,657,297.69 was due. It must appear that this amount was the sum total of the 1st and 2nd loans (and may have included the 3rd loan too). Then see plaintiffs' Exh. FLCF5, a notice of demand which claimed RM5,741,822.33 as the amount outstanding on 31 January 1986. But this was dated 14 January 1987. These documents showed that the plaintiffs did not keep separate accounts for each of the three but separated them later (after defence was filed).

(iii) The plaintiffs wrote to the Receivers and Managers on 3 May 1988 (plaintiffs' Exh. 58) about three months after the proceeds of sale was paid to them and about one month after the 2nd defendant had filed his defence (on 4 April 1988).

Legal Contentions

Plaintiffs' strongest argument was that ss. 60, 61 and 62 of the Contracts Act allow "the creditor", that is the plaintiffs, to appropriate the proceeds of sale as they wish. The plaintiffs claimed that there was no appropriation by the debtor, that is the defendants. In accordance with s. 61, plaintiffs appropriated at their discretion. One feature of s. 61 is that it does not specify any period of time within which a creditor must appropriate. The common law principles do not differ from the principles contained in s. 60 and 61. *Halsbury's Laws of England*, 4th Edn., Vol. 9, paras. 505-507. See *Re William Hall (Contractors) Ltd.* [1967] 1 WLR 948. In my opinion, if indeed the law permits them, plaintiffs should have appropriated within a reasonable time and this ought to have been before filing the suit.

Mr. Peter S.C Soong, learned Counsel for 1st and 5th defendants, on this point, contended that the plaintiffs were obliged to appropriate the proceeds of sale to satisfy the loans in accordance with the priority of the fixed charges registered against the land which specifically stated that the 2nd charge was subject to the 1st charge (see exhibit HTG-1 and HTG-2 annexed to affidavit of Datuk Hong Teck Guan sworn on 17 October 1990). This would mean that the right to appropriate accrued on 26 January 1988. Plaintiffs exercised that right on 3 May 1988 or three months after the commencement of this action and three weeks after the service of the statement of defence. This was another instance of the haphazard arrangement made by the plaintiffs in dealing with the defendants.

Both learned Counsel for the 1st and 5th defendants and for the 2nd defendant also claimed that the receivers of Seng Ho Pemeliharaan Udang had instructed the plaintiffs to utilize the proceeds of sale to pay off the 1st loan first. This was evidenced by the letter from the receivers' solicitors dated 3 October 1988 to the plaintiffs (see Exh. HTG3 annexed to the affidavit of Datuk Hong Teck Guan sworn on 17 October 1990). The letter dated 26 January 1988 from the receivers' solicitors to the plaintiffs clearly stated that the balance of the proceeds of sale was to be utilised to pay the loans (see p. 56 Exh. JD1 annexed to affidavit of Jimmy Dius affirmed on 11 October 1990). This was to show that the defendants had appropriated.

Both Counsel also argued that s. 94, Contract Act absolved their clients from the guarantee on the grounds that by the further encumbering of the land the plaintiffs had deprived the defendants of the benefit of the value of the land and had impaired and reduced the security when they granted the 2nd and 3rd loans. To that, the learned Counsel for the plaintiffs, Mr. Alex Decena, submitted that cls. 8 and 16 of the guarantee provided that (i) the

defendant's liability shall not be affected or prejudiced by the plaintiffs releasing the securities; and (ii) the plaintiffs may, without exonerating the guarantors and without reference to them, give up any securities. He then submitted that the effect of cls 8 and 16 disentitled the defendants to any rights under s. 94 of the Contracts Act. For clarity of thought, let me reproduce here:

From The Guarantee Document:

Clause 8:

> This guarantee and your rights under it shall be in addition to and shall not be in any way affected or prejudiced by your holding or taking any other or further guarantee or securities or by your varying, releasing or omitting or neglecting to enforce any such securities or by your varying or determining any credit to the principal or by your renewing bills of exchange, promissory notes or other negotiable instruments or giving time for payment or granting any other indulgence to or making any other arrangements with or accepting any composition from the principal or any person or persons, corporation or corporations liable on any bills of exchange, promissory notes or other negotiable instruments or securities held or to be held by you.

Clause 8 clearly spells out that the bank can take other or further securities and it can vary, release ... any such securities. Any variance in the agreement to which the surety has subscribed, made without his knowledge or consent, which may prejudice him ... will discharge the surety. See *Lord Cottenham* in 3 HLC 226. In other words, these securities must be those connected to the loan and not independent of it.

Clause 16:

> You may without exonerating the guarantors and without reference to the guarantors refuse further credit to the principal and may grant time or other indulgence to the Principal or any other person or persons liable to you on or in respect of any bills notes guarantees or undertakings and may give up or modify or abstain from perfecting or taking advantage of any securities or contracts and discharge any party or parties and accept or make any composition or arrangement and realise any securities renew bills and promissory notes when and in such manner as you may think expedient. You may accelerate the maturity of any obligation guaranteed or renew any credit or accommodation given to the principal or any other person or exchange or deal with any collateral security or charge the terms of any credit or accommodation. And the guarantors hereby expressly waive all requirements for diligence presentments demands protest and notice whatsoever and expressly declare that you may do all or any of the above things without in any way limiting restricting or discharging the liability of the guarantors. And you may enforce or have recourse to all remedies or means for recovering the money for the time being due and unpaid on the general balance of the principal's account at such time and in such order and in such manner as you may think fit and as to any security other than this guarantee without notice or demand to or of the guarantors or his or their executors administrators or legal representatives.

Clause 16 was what Mr. Decena described as the "catch-all" provision. The two clauses are supposed to be the bank's all-powerful and all-embracing licence to do what it wants, not caring whether or not the parties had foreseen and agreed to such action or concept. Clause 16, after so wordy a treatment, finally concludes that the actions, indulgence, freedom to give up securities or renew credit or deal with collateral without limit are all confined to "recovering the money for the time being due and unpaid". Obviously again the reference is to the loan on which the guarantee is signed and to which the guarantors have agreed to be accountable for. The surety, it is often said, is a favoured debtor. Lord Westbury LC in *Blest v. Brown* [1862] 4 De G. F & J 367, said:

> You bind him to the letter of his engagement. Beyond the proper interpretation of that engagement you have no hold upon him.

I cannot imagine both parties (or even the bank by itself) claiming that these two clauses operate to give the bank such freedom to do everything and anything with complete disregard to the fairness and justice of the matter. What basically these clauses say is:

> Yes, you are a bank. You can do anything but only pertaining to this loan which we guarantee. So if there are securities for this one loan, you can discharge some and call us to settle the balance but not for other loans to which we are not parties.

From The Contracts Act

Section 60:

> Where a debtor, owing several distinct debts to one person, makes a payment to him, either with express intimation, or under circumstances implying that the payment is to be applied to the discharge of some particular debt, the payment, if accepted, must be applied accordingly.

Section 61:

> Where the debtor has omitted to intimate and there are no other circumstances indicating to which debt the payment is to be applied, the creditor may apply it at his discretion **to** any lawful debt actually due and payable to him from the debtor, whether its recovery is or is not barred by the law in force for the time being to the limitation of suits.

Again here we can see clearly that the Contracts Act provides for "one debtor owing to one person several debts" and not several debts by different persons.

Several cases were cited and amongst these were *Ooi Boon Leong & Ors. v. Citibank N. A.* [1984] 1 MLJ 222. Here the appellants, being directors of the company, guaranteed the loan and there was no question of other loans, *D & C Nomura Merchant Bankers Bhd. v. Gunung Kuari Sdn. Bhd. & 3 Ors.* [1990] 1 CLJ (Rep) 752. This questioned the indulgence given as to time (of enforcement) and of the absence of enforcement of security documents.

Let me postulate two sets of circumstances:

(1) Where a customer obtains two or three loans from a bank and upon his coming into some money (say RM100,000) he pays into the bank without directing as to which loan account the RM100,000 is to be appropriated. (see s. 61)

(2) The same customer informs the bank at time he pays the RM100,000 to it that he wants the money to be appropriated to Loan No. 2 (and Not to Loan 1 or Loan 3). (Section 60)

In cases where banks grant two or three loans to a customer, example a housing loan, a fixed loan for the purchase of household items or machinery and an overdraft account, then s. 60 and 61 of the Contract Act would come into play. The two sets of circumstances do not apply to the situation where the defendants are in. The scenerio in the instant case was simple but all three Counsel neglected to submit that the important words in s. 60 (which also applies in s. 61 and 62) are "Where a debtor, owing several debts to one person..." The section deals only with the case of several distinct debts and does not apply where there is only one debt. Page 491 of *Pollock and Mulla's Indian Contract and Specific Relief Acts* by J. L. Kapur. In this action, "the debtor" for our purpose are the five defendants and they owe only one debt to the plaintiffs. Looking at cl. 5 of the guarantee, the 1st, 2nd, 3rd, 4th and 5th defendants became "principal debtors" and

accordingly as this was the only debt they were concerned with, there was no remedy which plaintiffs could gain from s. 61.

Interpretation of the Guarantee

I have pointed out briefly the implications of the wordings in the two clauses. No matter how one looks at cls. 8 and 16 of the guarantee. I cannot agree that these clauses disentitle the defendants to the rights under s. 94 of the Contracts Act 1950 because, going back to the basics of contract law, the consensus *ad idem* at the time the plaintiffs and the five defendants signed their guarantee was that the five defendants undertook the burden knowing and fully accepting that the security was furnished by the charge on the land at that point of time. In the "Guarantee" the five defendants (which for this action refers only to the 1st, 2nd, and 5th defendants) undertook to be liable only on the amount under the "Loan Agreement of even date". Clause 3 allowed the plaintiffs to "open any new account" (and not to lend any more) and cl. 6 specified that all monies received were to be regarded as payments in gross. It is also basic guarantee law that no guarantor is to be additionally burdened without his knowledge of the implications of his guarantee.

Section 94, Contracts Act 1950 states:

> 94. A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not: and, if the creditor loses or, without the consent of the surety, Parts with the security, the surety is discharged to the extent of the value of the security.
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> **Illustration**
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> (a) C advances to B, his tenant, RM2,000 on the guarantee of A, C has also a further security for the RM2,000 by a mortgage of B's furniture. C cancels the mortgage. B becomes insolvent, and C sues A on his guarantee, A is discharged from liability to the amount of the value of the furniture.

From the law and the illustration, it is evident that the guarantors were entitled to the benefit of every security which the creditor had against the principal debtor at the time when the contract of suretyship was entered into... that was, on 27 June 1980 and not a day later. Hence, the later loans extended without the five defendants' knowledge, albeit to the same customer, could not become their responsibility nor be their burden. I want it understood that in case of ambiquity when all other rules of construction fail, the Courts interprete the guarantee *contra preferentem,* that is against the guarantor. But the cardinal rule is that the guarantor must not be made liable beyond the terms of his engagement. *State of Maharashtra v. Dr. M.N Kaur* [1967] ASC 1634. I am therefore of the opinion that in these circumstances, the RM12.2 million realised from the sale of the charged land on 31 December 1987 must go towards settling the 1st Loan, that is the loan which was under contest here. As this loan (of RM3,200,00) expanded with interest and charges to RM5,741,822.33 as at 31 January 1986, there was more than sufficent to settle it.

I shall not deal with the balance though the plaintiffs may consider settling the 2nd Loan and then, if there was any balance, towards settling the 3rd Loan. Banks know quite well the rules in *Clayton's* case (or *Devaynes v. Noble* [1816] 1 MER 572 at 608), that is that the presumption is that the first item on the debit side of the account is intended to be discharged or reduced by the first item on the credit side and that the various items are appropriated in the order in which the receipts and payments are set against each other in the account. I am fortified by the statement of the law in *Halsbury's Laws of England* (4th Edn. Reissue) Vol. 3(1) at para. 197, p. 169:

> ... a surety ought not to be prejudiced by any departure from the rule of appropriation of items in order of date... *The Mecca* [1897] AC 286.

If the five defendants had guaranteed all the three loans then I can accept plaintiffs' contention. The bank would then be correct to take the action they took, presumably under s. 61. But clearly in the instant case I cannot allow this contention as it is wrong legally and morally.

At the outset, I want to stress that the position and rights of a banker under a guarantee depend on the character and form of the guarantee and the parties thereto. *Halsbury's Laws of England* (4th Edn. Reissue) Vol. 3 (1). Let me discuss briefly cls. 8 and 16 of the guarantee document. No doubt, these are the "catch-all" provisions or intended as the panacea for all the ills of any bank. But surely these clauses cannot mean that the guarantor signing them has divested himself of all and any protection which law and equity has clothed him. The words do not and cannot mean that the guarantor has given a free rein to the bank to do what it pleases to the utter damage, loss and consternation of the guarantor, its customer. I am of the further opinion that the words imputing freedom for the bank to do this, that and the other in cls. 8 and 16 must restrictively be confined to the loan which the guarantee refers to and does not amount to a licence for the bank to disregard the time factor, example see Clayton's Rule or to jeopardise the security or its proceeds in favour of a later or different loan to which the guarantors or defendants here have no control or even interest. One has to examine carefully the words and phrases in cls. 8 and 16 to realise that the banker has limits to what he can do with the security all of which binds the parties within the boundary of the loan. To find otherwise would turn a guarantee into something so sinister that the requirement of *consensus ad idem* cannot be met or satisfied. If that were so, then the guarantee cannot remain within contract law.

The reasons why plaintiffs had appropriated the proceeds in the manner they adopted are clearly in their own best interest. I understand the motive but I cannot accept the logic of it. Clearly the defendants' defence that they are absolved is grounded substantially on law, practice and business ethics. Under the circumstances, there is no other order I can make but to dismiss plaintiffs' application dated 22 April 1988 for O. 14 summary judgment. Order accordingly.

Also found at [1992] 2 CLJ 1074